

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)

Implementation of the Non-Accounting)
Safeguards of Sections 271 and 272 of the)
Communications Act of 1934, as amended)

CC Docket No. 96-149

Regulatory Treatment of LEC Provision)
of Interexchange Services Originating in the)
LEC's Local Exchange Area)

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**COMMENTS OF THE INDEPENDENT
TELEPHONE & TELECOMMUNICATIONS ALLIANCE**

The Independent Telephone & Telecommunications Alliance ("ITTA") hereby submits these comments in the above captioned proceeding in connection with the Commission's efforts to reclassify independent LECs as non-dominant carriers in the provision of in-region, interstate, domestic, inter-LATA services.

I Introduction

Nearly three years ago, 17 independent telephone companies joined together and formed the Independent Telephone & Telecommunications Alliance ("ITTA") to draw attention to the unique needs of the independent telephone industry. ITTA created a strong, unified voice for independent telephone companies, herein defined as those companies with less than two percent of the subscribed access lines nationwide ("Independent Telcos"), as Congress shaped the landscape governing telecommunications in the 21st Century. Now that Congress has enacted the Telecommunications Act of 1996 (the "1996 Act")¹, ITTA has turned its efforts to the

¹ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).

Commission to ensure that Congress' recognition in the 1996 Act of the unique role that independent telephone companies play in a competitive marketplace is implemented faithfully by the Commission.

To this end, now is the time for the Commission to regulate Independent Telcos as **non-dominant carriers** in their provision of interexchange services that are not separated from their local exchange. Non-dominant status will encourage independent telephone companies to provide innovative new telecommunications services. Separate affiliate requirements continue to hamstring Independent Telcos with outdated and counterproductive regulatory burdens that do not further the public interest. In an era of worldwide telecommunications competition, Independent Telcos exercise little, if any, market power because of their small operating territories that are highly vulnerable to competitive entry by telecommunications giants like AT&T and MCI, which by contrast, are lightly regulated.

Even by regulating Independent Telcos' offering of interexchange services, that are not offered from a separate affiliate, as non-dominant, Independent Telcos will still be highly regulated compared to their competitors that provide vertically integrated services free from all dominant carrier regulation. This is because one of the component parts of an Independent Telcos' service offering will remain highly regulated (*i.e.*, exchange and exchange access services). The Commission, however, can make an important first step in providing parity between industry sectors by deregulating Independent Telcos' integrated offering of interexchange services.

Unfortunately, the Commission's proposals to impose continued separation requirements on the independents found in the *NPRM* contravenes the spirit, if not the letter, of the 1996 Act.

These and other proposals found in the *NPRM* falter for the same reason—they are based upon the faulty supposition that the Independent Telcos retain some type of unspecified monopoly control over bottleneck facilities and hence require careful monitoring. As is pointed out in more detail below, this supposition no longer accords with the new reality of impending intense competition that has been created by the dual forces of the technological revolution and the 1996 Act.

A. ITTA's Members Should be Regulated as Non-Dominant Carriers in the Provision of Interstate, Domestic, Interexchange Services Originating in their Local Exchange Areas

The Commission asks whether it should modify the existing rules that require Independent Telcos to comply with certain separation requirements in order to qualify for non-dominant regulatory treatment in the provision of interstate, domestic interexchange services that originate in the local exchange areas. (*NPRM* ¶¶ 108-113). ITTA members answer with a resounding “yes”.

Commission regulation of local telephone companies is premised largely on the belief that, by virtue of its control over local exchange facilities, a telephone company possesses a monopoly in the local exchange.² This regulatory structure was developed in the Commission's *Competitive Carrier* proceeding,³ in which the Commission examined how it should regulate entities to reflect

² See, *In the Matter of Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services Section 251/252 Proceeding*, Notice of Proposed Rulemaking, CC Docket No. 96-21, FCC No. 96-59 at ¶ 9 (Released February 14, 1996)

³ *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 308 (1979); First Report and Order, 85 FCC 2d 1 (1980) (“*First Report and Order*”); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981) (“*Further NPRM*”); Second Further Notice of Proposed Rulemaking, FCC 82-187, 47 Fed. Reg. 17,308 (1982); Second Report and Order, 91 FCC 2d 59 (1982); Order on Reconsideration, 93 FCC 2d 54 (1983); Third Further Notice of Proposed Rulemaking, 48 Fed. Reg. 28,292 (1983); Third Report and Order, 48 Fed. Reg. 46,791 (1983); Fourth Report and Order, 95

and promote the increasing competition in telecommunications markets. In the *Competitive Carrier* proceeding, the Commission distinguished between two types of carriers--those with market power (dominant) and those without market power (non-dominant). The effect of dominant carrier status is a dramatically heightened, yet less efficient level of regulation. As a result, the Commission should not continue to apply to Independent Telcos the existing separation requirements established in the *Competitive Carrier Fifth Report and Order* in order for them to offer interstate, domestic and international Interexchange services originating in their local exchange areas on a non-dominant basis. *See NPRM* ¶ 144.

In the *Fifth Report and Order*, the Commission justified this separation requirement on the grounds of protecting the public against cost-shifting and anti-competitive conduct by an independent LEC that could result from its control of local bottleneck facilities. Regulation of local telephone companies historically was premised on the belief that these companies possessed the power to artificially inflate prices, or to price selectively in a predatory fashion by lowering rates for some customers and recovering shortfalls from others through "cross subsidization." With the revolution in telecommunications technology and the passage of the 1996 Act, however, this fear is no longer warranted. Continuing to apply these separation requirements now will only result in the diminution of competitive opportunity and equity within this segment of the industry. This conclusion applies even when considering the so-called "incumbent LECs." *NPRM* ¶ 153. Because of the new technological and competitive environment, even in the absence of the *Competitive Carrier* requirements, the independent LECs do not have the market power to gain

FCC 2d 554 (1983) ("*Fourth Report and Order*"), vacated *AT&T v. FCC*, 978 F.2d 727 (D.C. Cir. 1992) cert. denied, *MCI Telecommunications Corp. v. AT&T*, 113 S.Ct. 3020 (1993); Fourth Further Notice of Proposed Rulemaking, 96 FCC 2d 1191 (1984); Fifth Report and Order, 98 FCC 2d 1191 (1984) (*Fifth Report and Order*)

the ability to raise the price of in region, interstate, domestic interexchange services significantly above competitors by restricting output. *See NPRM* ¶ 157.

Moreover, as is discussed in more detail below, the basis for the Commission's concerns with bottlenecking and the ability to misallocate costs or raise rivals' costs have been superseded by advances in telecommunications technology and negated by the plethora of new entrants in the market that both prevent any company from exercising market power in a given market.

B. Relevant Product and Geographic Market Definitions Demonstrate that Independent Telcos Have No Market Power.

In the *Competitive Carrier* proceeding, the Commission defined a dominant carrier to be a carrier that "possesses market power."⁴ In determining whether an entity possessed market power, the Commission has focused on certain "clearly identifiable market features," including "the number and size distribution of competing firms, the nature of the barrier to entry, and the availability of reasonable substituted services," and whether the firm controlled "bottleneck facilities."⁵ Preliminary to determining whether a firm had market power and thus, entitled to non-dominant regulation, the relevant product and geographic markets for assessing market power must be identified. The Commission recently employed this analysis in determining that AT&T was a non-dominant carrier in the interexchange market.⁶ The Commission would be acting arbitrarily and capriciously if it did not continue to use this analytical framework, reinvigorated as necessary, given market and technological advances.

⁴ *First Report and Order*, 85 FCC 2d at 20-21.

⁵ *Id.*

⁶ *AT&T Non-Dominant Order* at ¶ 19.

1. Telecommunications Service is the Relevant Product Market

The Commission's proposal in the *NPRM* (§ 119) to identify the relevant product market for the Independent Telcos as "all interstate, domestic, interexchange telecommunications services" may be appropriate for this proceeding. Nevertheless, the Commission should consider carefully whether a more appropriate standard is a product market defined simply as "all telecommunications services." In the 1996 Act, Congress created an entirely new telecommunications market structure based on unleashing competition in every sector of the industry. By relying on the forces of competition, Congress has turned away from a regulated monopoly market structure and has embraced a competitive market model to bring enormous benefits to consumers of telecommunications. This open market structure envisions a wide new range of services offered by a bevy of telecommunications carriers who can provide these services at the lowest cost and in the most efficient manner. On a broad scale, cable companies soon will provide telephone service, and telephone companies will offer video services. Consumers will be able to purchase local telephone service from several competitors, and vice versa. Electric utility companies will offer telecommunications services. As a result, the competitive market structure that Congress created is broader in scope and breath than what the Commission has traditionally envisioned in the market place. No longer will firms be limited to provide solely interexchange services, local exchange services, access services or wireless services, rather entities will provide a whole range of services.

To accomplish this goal, the 1996 Act defines a new set of terms to assure that competitors in this revolutionized telecommunications market are not hamstrung by backward and counterproductive regulatory molds that do not take into consideration the new market realities.

Specifically, the 1996 Act defines “telecommunications services” as the “offering of telecommunications for a fee directly to the public. . . .”⁷ Moreover, “telecommunications” is also a defined term which “means transmission . . . of information of the user’s choosing without change in form or content”⁸ In addition, the 1996 Act’s imposition of interconnection duties on all telecommunications carriers, those providing telecommunications services, underscores Congress’ commitment to a broadly defined market structure. By using such broad definitions, Congress has ensured that the market will evolve in a fashion to ensure the benefits of competition are brought to American consumers.

The approach used by the Commission in the *Competitive Carrier* proceeding for assessing an interexchange carrier’s market power is a useful start to assessing the market power of Independent Telcos. In that proceeding the Commission determined that the relevant market for interexchange services was all interstate, domestic interexchange services with no relevant submarkets. This definition may have been appropriate when market structures prohibited provision of a wide range of services by the same carrier, but is clearly inappropriate in today’s market of open networks and competitive firms offering all services. Given the new market structure created by the 1996 Act, the relevant product market for assessing whether an Independent Telco has market power is all telecommunications services. This product market is sufficiently broad to accommodate new market realities as well as to ensure that the Commission’s regulatory structure does not hamstring new and existing competitors in the market.

⁷ 47 U.S.C. § 153(51).

⁸ 47 U.S.C. § 153(48).

Defining the relevant product market as all telecommunications services is also consistent with the analytical framework underlying the Department of Justice's Merger Guidelines, which are cited by the Commission in this *NPRM*. As the Commission there points out, the DOJ merger guidelines ground the analysis of market definition upon demand substitution factors.⁹ The Guidelines define a relevant product market as a "product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that market are likely to impose at least a 'small but significant and nontransitory' increase in price, assuming the terms of sale of all other products are held constant." The "small but significant" price increase is generally presumed to be five percent.

In trying to determine a relevant product market on the demand, the DOJ merger guidelines focus first upon the defendant's product and then hypothesize a "small but significant and nontransitory" price increase, and estimate how many buyers would shift to substitutes. If a larger number would substitute away, the market is too small. The analysis then proceeds by redrawing the market to include the "next best substitute" and repeats the process. When a grouping of products is identified where large numbers of customers could not substitute away in response to a small but significant price increase, the relevant product market has been defined.

Applying this demand driven model here underscores the reason that the relevant product market is "all telecommunications services." In the new environment created by the 1996 Act, a customer faced with a small but transitory price increase by the independent telephone company has an array of alternatives from which to choose. Many large firms already provide alternatives

⁹ See, *NPRM* ¶ 117.

to many Independent Telco services. Interexchange carriers are increasingly bypassing the local exchange carriers and are either self-supplying or purchasing network access from non-LEC entities. The ongoing revolution in telecommunications technology is another crucial factor supporting ease of demand substitution and hence auguring for the definition of the relevant product market as "all telecommunications services." Actual and potential competition now comes from other transmission media, including cable television facilities and wireless transmission which are competitors to local exchange companies. In several markets now, and in even more markets as the effects of the 1996 Act come to fruition, customers will be able to substitute these services for any non-competitive price increases by the Independent Telcos.

Other factors which the DOJ Merger Guidelines take into account also augur for a broad definition of the relevant product market. These are discussed below and include, the low barriers of entry into the product market as a result of the 1996 Act and the decreasing tendency towards concentration in the product market. Applying the analytical framework provided by the DOJ Merger Guidelines reveals that "all telecommunications services" is the only sensible definition of the relevant product market about which the Commission inquires.

2. The National Market is the Relevant Geographic Market

The Commission's proposal to evaluate an independent LEC's point to point markets in which calls originate in its local exchange areas separately from its markets in which calls originate outside those areas for the purposes of determining whether an independent LEC possesses market power in the provision of in-region, interstate, domestic interchange services is a serious mistake and should be reevaluated. (*NPRM* ¶126). In fact the Commission need look no further than its own determination in the *Fourth Competitive Carrier Report and Order* and

the AT&T Non-Dominance Order that found that the relevant geographic market was national in scope.¹⁰ The Common Carrier Bureau has just recently found that a similar city-pair market for interexchange services is unjustifiable. According to the Bureau, supply substitutability and low entry barriers indicate that the relevant market for interstate, interexchange services is national in scope. The Bureau further found that the segmentation of the national market into sub-markets ignores the fact that most networks possess alternative routing capabilities with nationwide or near nationwide service areas. As has been repeatedly demonstrated, telecommunications networks have redundant and multiple routing schemes, and thus there is rarely a single route between two cities.

Further support for defining the relevant geographic market as national in scope comes from the 1996 Act and the revolution in telecommunications technology which has shattered the notion of a company exercising local “bottleneck” control in any given market. This conception underlies much of the Commission’s early analysis of non-dominant and dominant carriers. The 1996 Act created a new model for local exchange interconnection which imposes a general duty to interconnect between all telecommunications carriers and to install network features and functions that assure nationwide network-level interoperability.¹¹ Indeed, all local exchange carriers have the duty to any other telecommunications carriers who seek network interconnection to provide resale of telecommunications services, number portability, dialing parity, access to poles, ducts and conduits and to establish reciprocal compensation for the transport and termination of traffic.¹² It is precisely these duties that open the local exchange network to

¹⁰ *Competitive Carrier Fourth Report and Order*, 95 FCC 2d at 574-75, ¶ 30.

¹¹ 47 U.S.C. § 251(a)(2).

¹² *Id.*; 47 U.S.C. § 252

competition by allowing competitors to interconnect their networks and resell complete packages of telecommunications services that destroy any possible “bottleneck” control exercised by the local exchange company. The 1996 Act also eliminated all state and local barriers to entry for telecommunications carriers. By unleashing new entrants into the market, any so-called “bottleneck” control that an Independent Telco could exercise is destroyed.

Taken together, the factors enumerated above augur strongly in favor of defining the relevant geographic market as the national market rather than the individual LEC’s point to point markets as the Commission now proposes.

C. Independent Telcos Face Competition from a Plethora of Existing and Emerging Sources

The 1996 Act preempted any State and local statute and regulation, or other State and local legal requirement, that may prohibit or have the effect of prohibiting any entity from providing interstate or intrastate telecommunications services. Indeed, now with national rules in place, and a landslide number of interconnection agreements being finalized, competitive local markets are becoming a reality.

The most immediate competitive threat to Independent Telcos is from Bell operating companies that are planning to offer competing local-phone service in territories in their regions where they do not offer services. As a result, competition may be first to arrive in those in-region markets where Independent Telcos operate because of the economies of scale that Bell operating companies already enjoy in their in-region territories. Indeed, the Bell operating companies are formidable rivals to other smaller telephone companies because of their network expertise, regional infrastructure, and financial strength.

Notwithstanding the 1996 Act's elimination of entry barriers, in each state where an Independent Telco operates, it is today subject to considerable competitive pressure from a plethora of existing sources. Competitive access providers (CAPs) are now a growing source of competition in many of the areas in which Independent Telcos operate. CAPs also are rapidly becoming formidable competitors, as the recently announced merger of MFS with WorldCom demonstrates.¹³ Since their emergence in 1987, CAPs have been able to exploit state-of-the-art fiber networks and their ability to flexibly price their high capacity services at deep discount. In today's environment, CAPs provide access alternatives to medium and large customers in the service areas of Independent Telcos. Indeed, the Commission's interconnection policies from 1992 to 1994, coupled with the 1996 Act, enable CAPs to aggregate individual customer traffic and thereby make their services available to virtually any business customer.

Cable television is another competitive alternative to Independent Telco service. At the end of 1994, the cable television industry had 59.7 million subscribers and passed 91.6 million homes, or 96 percent of all American television households.¹⁴ Penetration (*i.e.*, the number of subscribers as a percent of homes passed) rose 3.3 percent from the end of 1993 to a penetration rate of 65.2 percent at the end of 1994.¹⁵ Moreover, it appears as though the subscribership growth in 1994 has continued in the first three quarters of 1995.¹⁶ Cable television companies are

¹³ "WorldCom Buys MFS in \$14-Billion Deal Creating Major Telecom Competitor," *Communications Daily*, August 27, 1996.

¹⁴ *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Second Report and Order, CS Docket No. 95-61, FCC 95-491 at ¶ 7 (released December 11, 1995).

¹⁵ *Id.*

¹⁶ *Id.* at ¶ 16.

upgrading their networks by installing fiber at a rapid pace in preparation for future competition as evidenced by the 27 percent increase in capital expenditures in 1994 over 1993.¹⁷ Fiber cable networks add capacity, improve quality and reliability, and enable cable television operators to carry both voice and data traffic in competition with local exchange companies.

The ability to provide both cable and telephone service over a single facility is a reality today. For example, large, well-established companies, including Time Warner and Jones Interchangeable, are actively pursuing plans to offer local telephone service in their markets. Similarly, Cablevision has recently entered into an interconnection agreement with New York Telephone with the goal of offering telephony on Long Island to its 650,000 subscribers. U.S. West's recent purchase of Cablevision has accelerated and emphasized this trend.

Joint ventures between cable television operators and CAPs also are developing, offering further bypass alternatives for residential customers. Cable networks primarily serve residential neighborhoods while CAPs traditionally cover the business centers. Interconnected cable/CAP networks can hand off and receive traffic from each other, to be delivered to an Interexchange carrier's POP or to an end user's premises.

Wireless technologies, including cellular and personal communications services (PCS), also offer competitive alternatives to the wireline local loop. Today, there are over 25 million cellular service subscribers and the growth rate has approached or exceeded 50 percent each year.¹⁸ Indeed, the Commission recently estimated that cellular service is expected to reach 20 percent penetration, or approximately 54 million customers by the year 2000.

¹⁷ *Id.* at ¶ 33.

¹⁸ *Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, First Report, FCC 95-317 at ¶ 13 (released August 18, 1995).

Further, the Commission recently has licensed two additional wireless providers (PCS A and B Block providers) in every market in the country and is about to license the fifth wireless competitor in each market to the high bidders in the recently concluded C-Block PCS auction. Indeed, Sprint Spectrum has been offering all digital PCS services in the Washington-Baltimore area for nearly six months and BellSouth Mobility, DCS and Western Wireless have recently launched PCS services in seven markets across the country.¹⁹ These new wireless providers are building all digital nationwide networks that will provide superior quality to traditional cellular service with the expectation of offering local exchange and interexchange services.

Moreover, the Commission ruled that broadband Commercial Mobile Radio Service, including cellular and PCS and Specialized Mobile Radio ("SMR") services, providers be authorized to provide fixed wireless local loop service.²⁰ By this action, the Commission is fostering competitive local exchange service by allowing broadband CMRS providers to be able to offer the equivalent of local exchange service using existing spectrum allocations for PCS, cellular and SMR. Indeed, MCI just announced its intention to purchase a substantial amount of capacity from NextWave Telecom (a potential C-Block PCS licensee) over the next 10 years that will be used for fixed local loop services, thereby creating another substantial competitor in the local loop. Thus, by further opening the local network to wireless providers, the Commission has opened yet another competitor to the local exchange arena.²¹

¹⁹ *Communications Daily*, August 13, 1996 at 9.

²⁰ *Amendment of the Commission's Rules to Permit Flexible Service Offerings in the Commercial Mobile Radio Services, First Report and Order*, FCC 96-283 (released August 1, 1996).

²¹ "MCI Buys PCS Time from NextWave in Major Wireless Move," *Communications Daily*, August 27, 1996.

These dramatic and real changes have resulted in actual increased competition and an erosion of purported market power associated with the so-called "bottleneck." Independent Telcos, in order to survive in this increasingly competitive market, must be sufficiently facile to meet this competitive environment directly.

III. Public Interest Considerations Require The Offering of Interexchange Services on a Non-Dominant Basis

Dominant regulation of Independent Telcos' integrated offering of interexchange services is no longer in the public interest and will stifle Independent Telcos from meeting the challenges of competition directly. Non-dominant regulation will permit Independent Telcos to offer new and innovative services and to respond quickly and adeptly to change in the marketplace. In addition, regulatory parity should exist among all carriers which do not possess market power to ensure that a level playing field exists.

Dominant carrier regulation, in a competitive market, inhibits Independent Telcos from quickly responding to the competitive pressures brought by competitors. The time needed to prepare fully cost-justified tariffs (where applicable) coupled with longer tariff notice requirements impair an Independent Telco's ability to act quickly in the marketplace. Further the current regulatory process is "gamed" by competitors to impose artificial delay and secure a competitive advantage. Indeed, dominant carrier regulation imposes substantial compliance costs on Independent Telcos and on the Commission, in a time where resources on both sides are being squeezed. As the telecommunications market becomes increasingly competitive, the costs associated with the burdens resulting from regulatory requirements will not be able to be sustained. In fact, these regulatory requirements are antithetical to a truly competitive market. The primary goal of the 1996 Act is to create truly competitive markets, and in accomplishing this

goal the Commission should be reducing regulatory requirements rather than seeking areas in which it can impose additional requirements.

The Commission should regulate Independent Telcos integrated offering of interexchange services as non-dominant because these companies no longer have market power in providing telecommunications services in the Bell operating company region in which they operate. Independent Telcos have small market shares in any of the seven Bell operating company regions in which they operate. The 1996 Act assures that there will be an adequate supply of providers of telecommunications services offered by competitors given low barriers to entry and the interconnection obligations of telecommunications carriers of Independent Telcos, under the 1996 Act. Moreover, Independent Telcos cannot exercise any market power because existing and future capacity restrains them from restricting output and raising prices.

IV. CONCLUSION

Innovation in telecommunications and microelectronics worldwide require a transformation of the organization and regulation of America's telecommunications industry. Rapid innovation has not only blurred traditional distinctions between wireline, cable, and wireless media, it has lowered switching and transmission costs and opened the door to a panoply of new service providers. Indeed, Congress harnessed this rapid technological change and enacted a revolutionary market structure approach for telecommunications carriers to provide multiple services in all markets.

These changes have put to rest any concerns about an Independent Telco's so-called "bottleneck," and created considerable opportunities for customers and competitors of Independent Telcos. Independent Telcos seek only the reduction of counterproductive and

burdensome regulation by permitting Independent Telcos to offer interexchange services on an integrated basis as a non-dominant carrier. This proposal ensures that Independent Telcos receive the right to compete more fully and fairly so that competition can proceed on the merits.

Respectfully submitted,

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